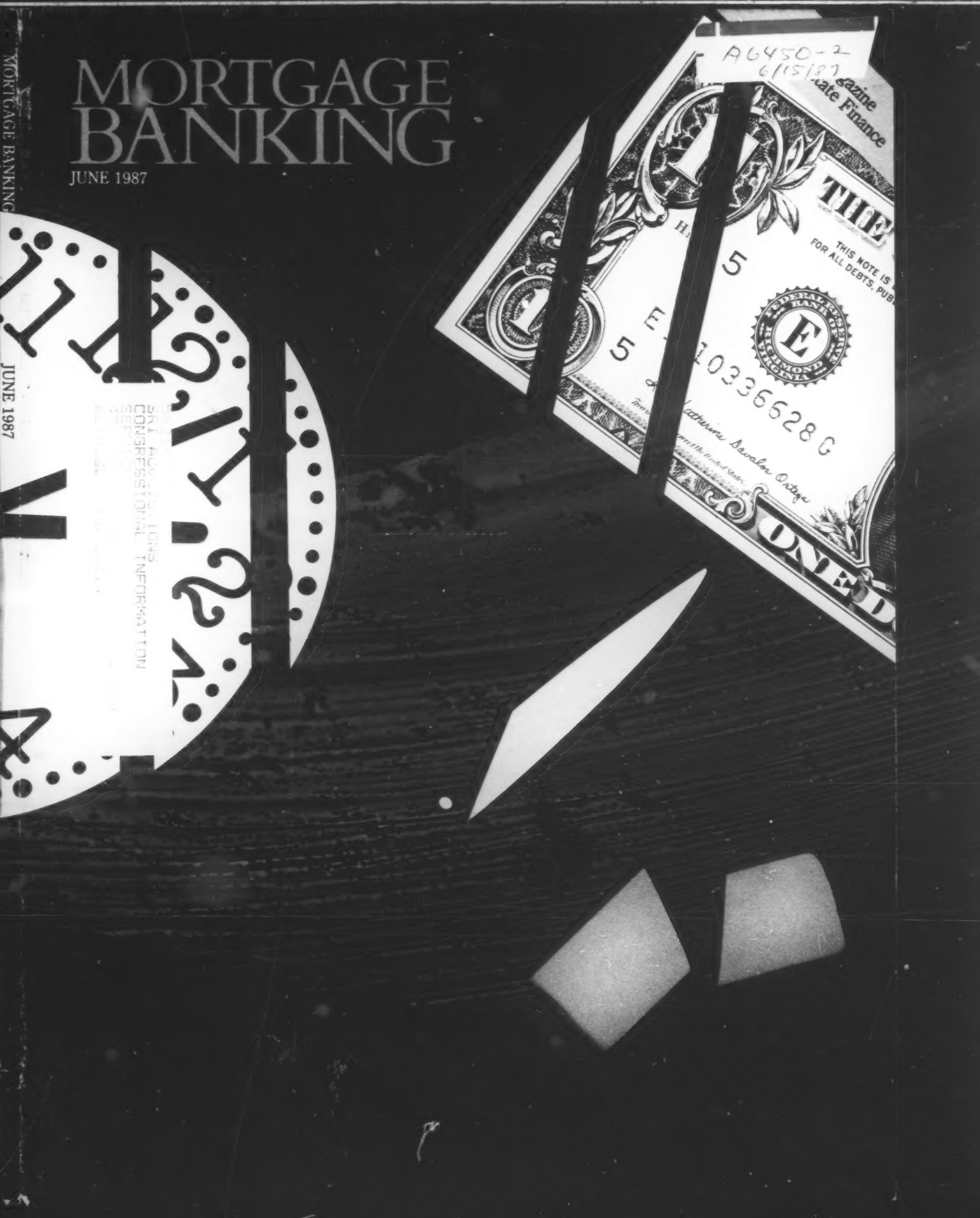
MORTGAGE BANKING

JUNE 1987



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SENIOR/SUBORDINATED PRODUCTS: BEYOND TRADITIONAL MORTGAGE SECURITIES
Barbara G. Novick and Bruce G. Sabath
Traditional obstacles that have kept many mortgage banking institutions from participating in the securities market are being overcome and eliminated. Major product innovations are providing the incentives to issue and invest in mortgage-related securities. This article gives details on First Boston's passthrough security.

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MORTGAGE MARKET TRENDS

Preliminary Department of Commerce estimates indicate that real GNP grew at a 4.3 percent annual rate in the first quarter of this year following a 1.1 percent increase during the final quarter of 1986. A sharp turnaround in non-farm inventory investment accounted for virtually all the quarterly gain in real GNP. In addition, the foreign trade sector also posted its second consecutive quarterly contribution to overall growth. However, all of the other components of GNP—personal consumption, business fixed investment residential investment and government purchases—declined in real terms during the January through March period.

The pace of inventory investment appears to be subsiding dramatically from first quarter levels, due to reduced auto production. Consequently, during the second quarter GNP will probably expand at less than a 2 percent annual rate. However, during the second half of this year, increases in consumer spending and business fixed investment, as well as further improvement in the trade sector, should allow for a moderate pick-up in growth, to an annual rate in the 2 to 2 1/2 percent range.

During the first quarter, personal consumption expenditures declined due to a sharp drop off in auto sales. Business fixed investment declined 13 percent, resulting in large measure from a further decline in new building construction. Although tax reform had an impact on the timing and magnitude of the drop, the high level of vacancy rates in commercial buildings will restrict activity in this area for some time to come. Producer's purchases of durable equipment also fell in the first quarter, but should begin to show modest improvement in the months ahead.

Residential fixed investment also posted a decline in the first quarter, down more than 7 percent from the fourth quarter level. While housing starts averaged 1.8 million units at an annual rate during the first quarter, up from 1.7 million during the fourth quarter, the level of starts had been declining throughout 1986, resulting in declining levels of residential building activity. Reductions in both single-family and multifamily housing starts are expected during the remainder of this year, particularly in view of the recent runup in interest rates. Housing starts should total 1,650,000 units for all of 1987, compared to 1.8 million units in 1986.

For the second consecutive quarter, real net exports added to GNP growth as the benefits of the dollar's decline in foreign exchange markets begin to be realized. Real net exports rose during the quarter because imports declined at a rate substantially faster than did exports. Although a portion of this improvement reflected a drop in oil imports, which are likely to increase in the months ahead, there was further improvement in the balance between non-farm exports and non-oil imports.

Prices rose somewhat faster during the first quarter than in 1986, but the outlook for inflation still remains reasonably optimistic. The Consumer Price Index rose at a 5.3 percent annual rate in the first quarter, up sharply from 2.9 percent in the fourth quarter. Higher oil prices and the declining dollar, which boosted import prices, were the major factors behind this increase in inflation. However, continued moderate increases in domestic wages and intense price competition should keep the overall inflation rate at about 4 1/2 percent for all of 1987.

Interest rates, and particularly long-term rates, have increased dramatically since March in response to developments in foreign exchange markets. A substantial decline in the dollar's value generated fears in credit markets of a withdrawal of foreign capital from the U.S., a worsening of inflation and a tightening of monetary policy. However, given the current economic fundamentals—modest growth of the economy and moderate wage gains—these fears appear to be exaggerated. Therefore, some retreat from the recent increases in rates is possible but it is unlikely that mortgage rates will drop below 10 percent again this year.

Gregory D. Luetscher
Economist

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rates			Actual			Seasonally Adjusted Annual Rates		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986												
OCT	155	109	46	1,657	1,199	458	146	103	43	1,565	1,109	456
NOV	116	83	33	1,637	1,200	437	109	72	37	1,613	1,083	530
DEC	114	80	34	1,808	1,334	474	132	82	50	1,910	1,282	628
1987												
JAN	105	75	30	1,816	1,332	484	98	67	31	1,690	1,186	504
FEB	102	77	26	1,833	1,373	460	101	76	25	1,763	1,346	417
1986 TOTAL	1,806	1,263	543				1,762	1,186	576			
1985 TOTAL	1,742	1,166	576				1,733	1,077	657			
3 MONTHS												
1987	350	259	91				352	254	98			
1986	374	254	120				381	240	141			
1985	346	236	110				349	224	125			
1984	377	264	113				397	256	141			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rates				Actual				Seasonally Adjusted Annual Rates			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1986																
OCT	27	27	60	40	267	247	680	463	27	27	52	40	260	249	598	458
NOV	22	20	43	31	273	275	608	481	19	21	41	29	260	287	605	461
DEC	19	19	39	36	307	397	593	489	21	19	43	49	306	318	574	712
1987																
JAN	16	16	44	29	336	431	589	460	14	14	41	29	294	389	570	437
FEB	9	14	44	34	278	381	664	510	15	16	43	27	355	403	601	404
1986 TOTAL	294	296	733	484					287	292	679	504				
1985 TOTAL	252	240	782	468					260	237	753	484				
3 MONTHS																
1987	46	54	146	104					54	56	144	98				
1986	47	42	182	103					47	44	178	113				
1985	33	32	181	100					44	32	170	104				
1984	27	35	215	101					33	36	214	114				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986														
OCT	326	54	362	6.3	231.3	106.9	32.6	91.8	1,143	675	468	167	117	50
NOV	266	48	358	6.2	230.6	107.1	33.1	90.4	1,125	667	458	148	106	41
DEC	268	49	366	5.8	226.2	107.5	30.3	88.4	1,104	658	446	175	120	55
1987														
JAN	216	53	355	6.3	225.1	108.4	31.1	85.6	1,089	658	431	137	91	46
FEB	241	58	349	6.3	229.0	109.6	29.5	89.9	1,097	670	427	118	78	40
1986 TOTAL	3,565	749										1,756	1,206	550
1985 TOTAL	3,214	688										1,704	1,170	534
3 MONTHS														
1987	785	179										380	253	127
1986	708	203										373	250	123
1985	645	170										365	247	118
1984	643	173										341	235	106

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

YEAR AND MONTH	TOTAL					1-4 UNITS				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
JUL	$60,720	$16,534	$21,687	$18,946	$3,553	$47,350	$15,860	$18,639	$12,360	$491
AUG	60,316	14,901	21,848	20,803	2,764	44,713	13,383	18,034	12,854	442
SEP	58,193	14,360	20,289	20,576	2,968	42,621	12,648	16,668	12,870	435
OCT	56,285	12,659	20,760	19,781	3,085	41,901	11,535	16,992	12,985	389
NOV	52,157	12,703	16,813	18,141	4,500	37,493	12,136	13,634	11,307	416
1986 TOTAL	603,948	142,884	218,118	205,503	37,443	438,441	131,628	176,063	126,936	3,814
1985 TOTAL	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
12 MONTHS										
1986	362,309	88,484	133,617	119,527	20,681	438,441	131,628	176,063	126,936	3,814
1985	221,217	42,705	89,760	74,201	14,551	242,112	63,296	109,286	68,224	1,306
1984	202,126	36,858	90,347	64,461	10,460	199,228	47,589	96,187	54,626	826
1983	179,373	43,386	66,210	60,976	8,801	197,527	59,672	81,524	55,605	726

LENDER ACTIVITY (Cont'd.)

LONG-TERM LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS					NONRESIDENTIAL				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
JUL	$3,034	$464	$1,345	$598	$627	$10,336	$210	$1,703	$5,988	$2,435
AUG	3,596	862	1,711	719	304	12,007	656	2,103	7,230	2,018
SEP	4,769	1,326	1,897	1,312	234	10,803	386	1,724	6,394	2,229
OCT	3,560	735	1,933	735	157	10,824	389	1,835	6,061	2,539
NOV	2,661	190	1,537	576	358	12,003	377	1,642	6,258	3,726
12 MONTHS										
1986	39,363	7,172	19,877	8,591	3,723	126,134	4,084	22,168	69,976	29,906
1985	28,392	2,746	15,612	7,262	2,772	99,941	3,114	20,485	52,387	23,955
1984	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
1983	16,169	566	8,521	5,485	1,597	60,965	3,102	13,837	30,410	13,616

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH					OUTSTANDING				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1986										
JUL	$45,221	$10,430	$23,101	$8,853	$2,837	$137,634	$27,902	$53,058	$36,389	$20,285
AUG	50,492	10,930	20,522	16,183	2,857	167,546	28,195	51,546	67,517	20,293
SEP	48,050	11,297	19,442	15,024	2,287	159,746	25,320	51,957	62,601	19,868
OCT	43,470	8,959	19,202	12,593	2,716	138,410	17,784	49,878	51,605	19,143
NOV	35,692	8,263	17,111	7,554	2,764	129,766	20,974	48,994	40,726	19,072
1986 TOTAL	527,397	128,480	231,915	127,902	39,100					
1985 TOTAL	324,089	59,551	170,755	61,311	32,472					
12 MONTHS										
1986	527,397	128,480	231,915	127,902	39,100					
1985	324,089	59,551	170,755	61,311	32,472					
1984	258,986	44,893	146,184	47,065	20,844					
1983	249,401	70,128	123,361	38,195	17,717					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA[3]	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1986												
OCT	249	128	38	83	162	$11,293	75	$4,556	28	$2,024	59	$4,713
NOV	201	101	38	62	191	12,960	112	6,927	32	2,257	47	3,776
DEC	215	111	39	65	176	12,313	88	5,531	39	2,768	49	4,014
1987												
JAN	208	120	41	47	175	12,143	95	5,864	38	2,718	42	3,561
FEB	243	153	42	48	n.a.	n.a.	n.a.	n.a.	44	3,255	33	2,812
1986 TOTAL	3,283	1,908	452	923	1,770	122,474	839	51,616	345	24,720	586	46,138
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
3 MONTHS												
1987	296	n.a.	132	164	n.a.	n.a.	n.a.	n.a.	142	10,393	114	9,712
1986	720	477	81	162	324	21,926	149	9,189	60	4,169	115	8,568
1985	447	179	46	222	258	16,584	58	3,208	37	2,416	163	10,960
1984	450	129	55	266	336	21,197	70	3,653	65	4,194	201	13,350

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA Portfolio Comm.	FNMA Portfolio Purc.	FNMA Mortgage-Backed Securities Outstanding	FNMA Mortgage-Backed Securities Issued	FHLMC* Comm. to Sell	FHLMC* Comm. to Buy	FHLMC* Mtg. Purc.	FHLMC* Mtg. Sold	GNMA Pass-Through Securities Applications	GNMA Pass-Through Securities Issued
1986										
OCT	$2,375	$3,784	$89,573	$5,535	$11,595	$9,356	$11,566	$11,401	$9,859	$10,221
NOV	1,811	2,549	93,525	5,636	8,926	9,356	9,862	10,540	13,319	9,612
DEC	1,272	2,336	97,174	5,494	7,993	8,742	11,306	11,579	10,377	12,123
1987										
JAN	948	1,364	101,687	6,363	n.a.	n.a.	n.a.	n.a.	13,932	10,624
FEB	912	979	104,670	4,691	n.a.	n.a.	n.a.	n.a.	11,668	9,692
1986 TOTAL	32,987	30,826	—	60,566	n.a.	n.a.	n.a.	n.a.	152,911	98,169
1985 TOTAL	20,225	19,848	—	23,649	44,085	46,762	44,012	44,085	64,360	45,868
3 MONTHS										
1987	4,528	3,759	—	15,681	n.a.	n.a.	n.a.	n.a.	36,473	31,052
1986	5,810	3,757	—	9,020	106,563	136,179	103,474	102,433	30,929	15,362
1985	4,830	5,758	—	3,820	44,025	56,689	44,012	41,454	12,511	8,126
1984	5,328	4,822	—	3,783	30,743	34,737	21,885	20,489	10,005	8,235

*FHLMC Year to date totals are periods Jan.-Dec. 1984-1986.

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES: FHA OPINION SURVEY: FHA New[4]	CONVENTIONAL New	CONVENTIONAL Existing	FHLBB SURVEY: CONVENTIONAL New	CONVENTIONAL Existing	FNMA: 1 Yr. ARM (1%/Yr.)	FRM Conv.	APARTMENTS[5]
1986								
NOV	9.26%	9.47%	9.47%	9.91%	9.84%	7.76%	9.440%	11.54%
DEC	9.21	9.33	9.36	9.69	9.65	7.94	8.973	11.09
1987								
JAN	8.79	9.09	9.10	9.51	9.53	8.31	8.815	10.81
FEB	8.81	9.04	9.04	9.23	9.21	8.48	8.668	10.25
MAR	8.94	9.19	9.20	9.14	9.09	8.06	8.633	10.24

YEAR AND MONTH	CURRENT SECONDARY MARKET YIELDS: GNMA[6]	FNMA[6]	FHLMC[6]	SELECTED SECURITIES: A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1986							
NOV	8.78%	8.91%	8.94%	9.31%	7.25%	5.42%	5.76%
DEC	8.40	8.48	8.50	9.08	7.11	5.53	6.10
1987							
JAN	8.22	8.31	8.26	8.92	7.08	5.44	5.84
FEB	8.06	8.21	8.17	8.82	7.25	5.59	6.05
MAR	8.12	8.25	8.22	8.84	7.25	5.59	6.16

YEAR AND MONTH	SPREADS (Basis Points): FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1986				
NOV	18	153	166	169
DEC	29	129	137	139
1987				
JAN	−13	114	123	118
FEB	−1	81	96	92
MAR	10	87	100	97

NA—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.